

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MAR 10 1969

DON R. THOMPSON AND MILDRED THOMPSON,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE
TAX COURT OF THE UNITED STATES

REPLY BRIEF FOR THE PETITIONERS

FILED

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Don R. Thompson
Mildred Thompson
Petitioners,
Suite 1000 WR
177 North Church Avenue
Tucson, Arizona 85701

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I

THE STATUTE IS NOT SO PERFECTLY CLEAR AND
SUSCEPTIBLE OF ONLY ONE MEANING THAT RESORT
SHOULD NOT BE HAD TO STATUTORY CONSTRUCTION.

The basic thrust of respondent's brief is that the language of the statute is clear and unequivocal. Petitioners' opening brief discussed the ambiguity of the statute (pp. 9-10) and the Tax Court itself recognized that the language of the statute is ambiguous. As the Supreme Court said in U.S. v. Correll, 88 S.Ct. 445, 389 U.S. 299 (20 AFTR 2d 5845) (fn. 16), "More than a dictionary is thus required to understand the provision here involved, and no appeal to the 'plain language' of the section can obviate the need for further statutory construction." The Correll case involved the question of travel expenses while away from home for federal income tax purposes, but the caveat of the Supreme Court would seem to be as applicable to the tax language with which we are here concerned. The Supreme Court has also pointed out, in a nontax case, National Woodwork Manufacturers Association v. N.L.R.B., 386 U.S. 612 (1967, fn. 5), "Before the true meaning of a statute can be determined consideration must be given to the problem in society to which the legislature addressed itself . . ."

II

AT TRIAL, RESPONDENT ADMITTED THAT IF RESORT TO
LEGISLATIVE INTENT WAS PROPER, THEN PETITIONERS
WERE ENTITLED TO THE INVESTMENT CREDIT.

At the time of trial, petitioners understood that respondent based his case on the "lack of ambiguity" argument, and admitted that if there was ambiguity in the statute petitioners were entitled to the investment credit. In the footnote to page 13 of respondent's brief before

this Court, respondent incorrectly states petitioners' argument on this point. Petitioners do not contend that Commissioner's attorney "admitted that they should have the investment credit available to them." What petitioners contend, as is set forth in point 2 on page 6 of petitioners' opening brief to this Court, is that respondent admitted at trial that if the statute was ambiguous, then the intent of Congress was not to deny the petitioners an investment credit in such a circumstance as this. Petitioners would suggest that the Court read the appropriate section of the transcript (p. 7, lines 11-23) and determine for itself what respondent's attorney was admitting or not admitting. As pointed out by the Tax Court in another matter (Frances M. Cole, TC Memo 1960-278) ". . . It is axiomatic that Courts and opposing parties are entitled to rely on admissions of counsel made during the trial of a cause; they are officers of the Court representing their client, and their admissions so made bind their principle. Pratt v. Conway, 49 S.W. 1028 (Mo. Sup.)."

III

IT IS UNCONTROVERTED THAT THE 1963 ACQUISITION OF THE PROPERTY BY PETITIONERS WAS A PURCHASE AND WAS SO TREATED BY RESPONDENT--AND THE TAX COURT FINDING TO THE CONTRARY IS WITHOUT SUPPORT.

The page 13 footnote to respondent's brief is an admission that the respondent did treat the repossession "as a purchase for purposes of computing gain . . ." While this is not controverted anywhere in the proceedings, the acknowledgement that the repossession transaction was treated as a purchase for all federal income tax purposes, although carefully avoided throughout the body of respondent's brief, is an admission of the correctness of one of the four specifications of error set forth by

petitioners on page 6 of their opening brief. The Tax Court found, as a fact, that a purchase had not taken place in 1963 (R. 101). Said the Tax Court, "In the first place, it (the investment credit) only applied to property acquired by purchase after December 31, 1961. Petitioners first acquired this property in or about 1957." This finding of fact was directly contrary to the stipulations, the positions of both parties, and now to this admission in the page 13 footnote to respondent's brief before this Court. If for no other reason than this erroneous finding of fact on the part of the Tax Court, this case should as a minimum be remanded for further proceedings before that Court.

IV

RESPONDENT TREATS THE 1963 TRANSACTION AS ONE WHERE A NOTE WAS USED TO PURCHASE PROPERTY IN ORDER TO FIND A TAXABLE GAIN ON DISPOSITION OF THE NOTE, BUT ARGUES THAT NO TRANSACTION TOOK PLACE IN ORDER TO DENY A SMALL AMOUNT OF INVESTMENT CREDIT ON THE SAME TRANSACTION.

The respondent argues that the petitioners "invested no additional funds in the property after 1957." (Brief 5). In fact, the petitioners owned a negotiable promissory note, which taxpayers transferred as the consideration in connection with their purchase of the property in 1963. That negotiable promissory note was property, that property was the consideration paid for the assets acquired in 1963, and the transaction in which this happened met the definition of "purchase" set forth in the Internal Revenue Code and specifically made applicable to this transaction by the Congress. See argument I, pp. 8 and 9 of petitioners' opening brief.

When it comes to collecting tax on the disposition of the note, respondent is there with an extended hand eager to take the position that the petitioners purchased the subject property in 1963 because that position

produces revenue; but when it comes to allowing an investment credit, the extended hand is withdrawn and respondent's attitude changes to a complete disavowal that anything ever happened to change the relation of the petitioners to the property at any time during the period 1951 through 1963. It seems to the petitioners that the government must be held to some standard of consistency, and not allowed to play a "head's I win, tails you lose" type of game in the tax treatment of a simple transaction. Since petitioners were taxed on the theory that they paid for this property with the note that they owned, and thus realized gain on the disposition of the note, then the government should not be able to argue that in fact the property was not purchased in 1963 after all.

V

THE COMMITTEE REPORT'S EXAMPLES INVOLVE SITUATIONS WHERE THE BUYER USED THE EQUIPMENT IMMEDIATELY BEFORE THE PURCHASE AS WELL AS BEING SITUATIONS WHERE THE BUYER WAS NOT ADDING TO HIS PRODUCTIVE FACILITIES. PETITIONERS QUALIFY FOR THE CREDIT ON BOTH TESTS.

On page 9 of its brief, respondent argues that the examples in the Committee Report are not intended "to illustrate the necessity for immediacy, but instead, show that the credit is not available where an asset acquisition does not result in the expansion or modernization of the user's productive facilities." Respondent does not attempt to deny, however, that the three examples do all deal with situations where the person using the property after the acquisition is the same person who used it immediately before the acquisition. Respondent does not explain through what sort of extrasensory perception it is able to tell what the Committee was attempting to illustrate with its examples. Certainly, use immediately before the change of ownership was one of the things that each example had in common. Another

the user's productive facilities."

Prior to the purchase in 1963, petitioners had no productive facilities. They had previously sold their business and were not engaged in any business operation at all. As to them, the purchase of these assets in 1963 was an expansion of their productive facilities.

On page 11 of its brief, respondent argues that "The sale and subsequent foreclosure by taxpayers should not enable them to claim a credit which was designed to encourage additional investment after December 31, 1961." But Congress deliberately put an exception to the new investment rule into the statute to cover up to \$50,000 of used equipment. It put a definition of "purchase" into the statute, and the taxpayers' transaction clearly meets that definition. In terms of the economy as a whole, no purchase after 1962 of used equipment which had been originally purchased new before 1962 added anything to the economy, but nevertheless such purchases were covered by the investment credit as used equipment purchases up to a limit of \$50,000.

If petitioners transferred their note to a controlled corporation prior to repossessing the property, and the corporation had been the entity which actually proceeded to engage in the purchase transaction in question here, there seems no question under the language of the statute that that corporation would have been entitled to receive an investment credit. And, if the corporation had made an election to be taxed under the provisions of Section 1372, that investment credit would have been passed through and available to the individual stockholders, petitioners herein, on their personal individual income tax returns. It seems ridiculous to assume that Congress, which put the \$50,000 allowance for used equipment into the statute

as a benefit for small business, would have so exalted form over substance as to put such a premium upon slight changes in the form of doing business as is implied in the argument of respondent.

VI

THE COMMITTEE'S EXAMPLES BASICALLY INVOLVED SITUATIONS WHERE THE COMMITTEE WOULD HAVE ANTICIPATED THAT THERE WOULD BE NO INVESTMENT CREDIT RECAPTURE. THAT, IN ONE EXCEPTIONAL SITUATION UNDER THE REGULATIONS SUBSEQUENTLY PROMULGATED, A RECAPTURE COULD POSSIBLY RESULT, DOES NOT ALTER THE GENERAL STATEMENT.

On page 12 of its brief, respondent argues that taxpayers are incorrect with regard to the three examples in Section 1.48-3(a) of the regulations. Respondent bases that contention on the fact that in one of the three situations cited there is a possible factual pattern in which there would be a recapture of the investment credit. That there may be an exception to a general rule does not make the general rule any the less valid.

Respondent also advances the interesting proposition that somehow there is no relationship between the regulations promulgated by the Treasury Department in 1967 and the statute as enacted by the Congress in 1952. The argument is that "A prior statute could not have been intended to correct a subsequent regulation." But respondent misconstrues petitioners' argument. Petitioners' argument is simply that Congress was aware of the implications of the statute it was enacting, and that in the three examples given in the Committee Report on Section 48(c), Congress logically contemplated that a recapture transaction would not be involved. Unless respondent is taking the position that Treasury regulations are, in themselves, the enactment of legislation, petitioners find it a little hard to follow

the argument and feel that respondent has simply not understood what petitioners are trying to say, which is that in trying to explain the abuse that Section 48(c) was attempting to forestall, Congress was aware of what the reasonable interpretation of its own language should be and was using as examples situations where it did not think the investment credit would be recaptured.

VII

SAYING THAT A REPOSSESSION CAN NEVER QUALIFY
FOR THE INVESTMENT CREDIT CREATES AN IMPEDIMENT
TO LEGITIMATE TRANSACTIONS AND WAS NEVER INTENDED
BY CONGRESS.

Respondent's final argument that the interpretation it advances is not a deterrent to deferred payment sales any more than it is to other sales again exalts form over substance. What petitioner was pointing out is that if a seller is going to have to sustain an investment credit recapture as a result of the sale of property, the seller is going to be less willing to enter into a deferred payment sale. He will now know that if he does have to repurchase the property, he will in no wise be able to recoup the investment credit which he has had to pay back because of the sale. Thus, advisors to sellers will have to advise them that a sale that is not a deferred payment sale is preferable, and the taking of other collateral than the property being sold is desirable, since foreclosure on that other collateral will not mean that an investment credit cannot be obtained upon its acquisition. Or instead of making a sale, the "seller" will now cast his transaction in the form of a lease with an option to purchase for a nominal amount after all payments have been made. This

is a result in no wise directed by Congress anywhere in the statute nor even by the Treasury Department in its regulations.

VIII

AN "ABUSE" IS A DELIBERATE AND VOLUNTARY ACT.
PETITIONERS INCURRED A TAX LIABILITY OF OVER
\$4,000 AS THE RESULT OF THEIR REPOSSESSION,
AND IT IS HARDLY TAX AVOIDANCE OR "ABUSE" TO
ALLOW THEM AN INVESTMENT CREDIT OF \$2,000 IN
THE SAME TRANSACTION.

The language with which we are concerned in Section 48(c) was enacted "to prevent abuse." The idea of preventing an abuse is that the abuse situation is one which is somehow within the control of the person who is perpetrating the abuse. A sale that is followed by a repossession some time later of the property that is sold is hardly a planned transaction carried out to garner tax benefits. To say that the petitioners were perpetrating an abuse is stretching the idea of tax avoidance to irrational limits. They had a \$19,593.49 gain on repossession taxed to them (R. 7), which was the major cause of their \$4,350.43 tax deficiency for 1963 (R. 6). The maximum investment credit petitioners could obtain if they won this case is \$2,164. The examples in the Committee's Report are all situations where the taxpayer is voluntarily taking an action in order to achieve certain tax and economic benefits. The instant situation simply does not fit into that pattern.

IX

PETITIONERS WAIVE ORAL ARGUMENT AND SUBMIT THEIR
CASE WITH THIS BRIEF.

Because of the rather clear-cut nature of the issues here involved, petitioners herewith submit their case to the Court with the filing of this brief and waive their right to oral argument before the Court. Petitioners would not wish the Court to construe their failure to appear for oral argument as a lack of interest in the outcome of this matter, but rather as a reflection of the confidence taxpayers have in the ability of this Court to fairly decide this issue based upon the record and the briefs.

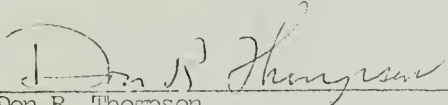
Petitioners have already expended more than the amount that is in controversy in bringing this case to the stage it is now in. However, petitioners have felt that the issue is of importance. The only other taxpayers who will suffer from the holding of the Tax Court are also small businessmen. The extension of the investment credit to only up to \$50,000 of used equipment per year rather effectively limits its availability to the small business people of the United States. It was to benefit them that the Congress enacted this provision. A purchase of property through repossession of property previously sold as effectively restores that property to productive use and as positively benefits the economy as does any other purchase of productive property. It is petitioners' firm conviction that the spirit of the legislation as to used equipment, which was designed to furnish an incentive to small businessmen and a help to small business in coming into being and in effectively competing, does not support the narrow interpretation that is being advanced by respondent.

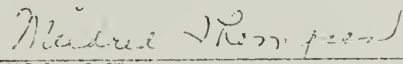


CONCLUSION

For the reasons stated above, the decision of the Tax Court is erroneous and should be reversed.

Respectfully submitted,


Don R. Thompson


Mildred Thompson

Petitioners
Suite 1000 WR
177 North Church Avenue
Tucson, Arizona 85701

December 23, 1968

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.


Don R. Thompson, Petitioner

December 23, 1968

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on respondent by mailing four copies on this 27 day of December, 1968, in an airmail envelope, with postage prepaid, properly addressed to respondent as follows:

Mitchell Rogovin
Assistant Attorney General
U.S. Department of Justice
Washington, D.C. 20530

Don R. Thompson

by

Betty J. J. J.

